No. 96-845

Supreme Court, U.S.
FILED
JAN 31 1997
CLERK

In The

Supreme Court of the United States

October Term, 1996

TIMOTHY J. ANDERSON, NEIL SINGER and ARTHUR SINGER, On Behalf Of Themselves And All Others Similarly Situated,

Petitioners,

v.

GARY W. CLOW, DOUGLAS L. WHITING, ROBERT W. JOHNSON, ARTHUR J. COLLMEYER, JOHN R. WITZIL, STAC ELECTRONICS, INC., ALEX. BROWN & SONS, INC., and MONTGOMERY SECURITIES,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF ALEX. BROWN & SONS INCORPORATED AND MONTGOMERY SECURITIES IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

JOHN R. REESE*
CHARLENE S. SHIMADA
HENRY A. CIRILLO
Three Embarcadero Center
San Francisco, California
94111
Telephone: (415) 393-2000

Attorneys for Respondents Alex. Brown & Sons Incorporated and Montgomery Securities

**Counsel of Record*

McCUTCHEN, DOYLE, BROWN & ENERSEN, LLP
Of Counsel

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

Should the Court review either the court of appeals' holding that (1) Rule 9(b)'s requirement that "in *all* averments of fraud" the circumstances must be stated with particularity applies to a Section 11 claim that "sounds in fraud," or that (2) the prospectus *in this case* "include[d] enough cautionary language or risk disclosure that reasonable minds could not disagree that the challenged statements were not misleading" where neither holding:

- conflicts with a decision of any other court of appeals or of this Court; or
- has any significance beyond the parties, or made any difference to the outcome of this case because, as the court of appeals found, either the prospectus disclosed the very information petitioners claimed was not disclosed or defendants had no obligation to disclose it in the first place?

LIST OF RELATED ENTITIES PURSUANT TO SUPREME COURT RULE 29.6

Pursuant to Supreme Court Rule 29.6, the following information is provided by Alex. Brown & Sons Incorporated and Montgomery Securities.

Alex. Brown & Sons Incorporated is owned by Alex. Brown Incorporated, which has issued shares to the public. Alex. Brown & Sons Incorporated has no subsidiary or affiliate that has issued shares to the public.

Montgomery Securities is not a corporation.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

LIST OF RELATED ENTITIES ii

INTRODUCTION 1

STATEMENT OF THE CASE 4

REASONS FOR DENYING THE WRIT 8

I. SUMMARY OF ARGUMENT 8

II. THE NINTH CIRCUIT'S DECISION TO APPLY RULE 9(b) TO SECTION 11 CLAIMS SOUNDING IN FRAUD DOES NOT WARRANT REVIEW BY THIS COURT 9

A. There Is No Conflict On This Issue Among The Courts Of Appeals Or With This Court's Decision In *Leatherman* 9

B. The Decision Was Reasonable And Does Not Raise An Important Federal Question 12

III. THE NINTH CIRCUIT'S APPLICATION OF THE "BESPEAKS CAUTION" DOCTRINE DOES NOT WARRANT REVIEW BY THIS COURT 18

CONCLUSION 24

TABLE OF AUTHORITIES

Page

CASES

Acito v. IMCERA Group, Inc., 47 F.3d 47 (2d Cir. 1995) 13

American Title Ins. Co. v. Lacelaw Corp., 861 F.2d 224 (9th Cir. 1988) 14

Anderson v. Clow, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,807 (S.D. Cal. 1993) 4, 14

Anderson v. Clow, [1994-95 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,367 (S.D. Cal. 1994) 6

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) 13

Competitive Associates, Inc. v. Fire Fly Enterprise, Inc., 59 F.R.D. 336 (S.D.N.Y. 1972) 11

Degulis v. LXR Biotechnology, Inc., 928 F. Supp. 1301 (S.D.N.Y. 1996) 11, 17

DiLeo v. Ernst & Young, 901 F.2d 624 (7th Cir.), *cert. denied*, 498 U.S. 941 (1990) 13, 16

Gasner v. Board of Supervisors, No. 96-1010, 1996 WL 741803 (4th Cir. Dec. 31, 1996) 20

Glassman v. Computervision Corp., 90 F.3d 617 (1st Cir. 1996) 23

Haft v. Eastland Financial Corp., 755 F. Supp. 1123 (D.R.I. 1991) 11

Harden v. Raffensperger, Hughes & Co., Inc., 65 F.3d 1392 (7th Cir. 1995) 19, 20, 21, 22

TABLE OF AUTHORITIES – Continued

Page

Hershey v. MNC Financial, Inc., 774 F. Supp. 367 (D. Md. 1991) 11, 15

Husted v. Amrep Corp., 429 F. Supp. 298 (S.D.N.Y. 1977) 12

I. Meyer Pincus & Assocs. v. Oppenheimer & Co., 936 F.2d 759 (2d Cir. 1991) 20

In re AnnTaylor Stores Sec. Litig., 807 F. Supp. 990 (S.D.N.Y. 1992) 11

In re Chambers Development Sec. Litig., 848 F. Supp. 602 (W.D. Pa. 1994) 11, 17

In re Computervision Sec. Litig., 869 F. Supp. 56 (D. Mass. 1994) 23

In re Donald J. Trump Casino Sec. Litig., 7 F.3d 357 (3d Cir. 1993), *cert. denied*, 510 U.S. 1178 (1994) 20, 21

In re Lilco Sec. Litig., 625 F. Supp. 1500 (E.D.N.Y. 1986) 11

In re Stac Electronics Sec. Litig 89 F.3d 1399 (9th Cir. 1996) ..... *passim*

In re Time Warner Sec. Litig., 9 F.3d 259 (2d Cir. 1993), *cert. denied*, ___ U.S. ___, 114 S. Ct. 1397 (1994) 13

In re VeriFone Sec. Litig., 11 F.3d 865 (9th Cir. 1993) 16

In re VeriFone Sec. Litig., 784 F. Supp. 1471 (N.D. Cal. 1992), *aff'd*, 11 F.3d 865 (9th Cir. 1993) 17

TABLE OF AUTHORITIES – Continued

Page

In re Worlds of Wonder Sec. Litig., 35 F.3d 1407 (9th Cir. 1994), *cert. denied*, ___ U.S. ___, 116 S. Ct. 185 (1995) 19

Krim v. BancTexas Group, Inc., 989 F.2d 1435 (5th Cir. 1993) 21

Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit, 507 U.S. 163 (1993)..... 2, 10, 12

Luce v. Edelstein, 802 F.2d 49 (2d Cir. 1986)..... 23

Lucia v. Prospect Street High Income Portfolio, Inc., 769 F. Supp. 410 (D. Mass. 1991), *aff'd*, 36 F.3d 170 (1st Cir. 1994) 11

Melder v. Morris, 27 F.3d 1097 (5th Cir. 1994) ... 10, 15, 17

Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 949 F.2d 243 (8th Cir. 1991)..... 20

Moran v. Kidder Peabody & Co., 609 F. Supp. 661 (S.D.N.Y. 1985), *aff'd*, 788 F.2d 3 (2d Cir. 1986) 10

Neubauer v. Eva-Health USA, Inc., 158 F.R.D. 281 (S.D.N.Y. 1994) 11

Olkey v. Hyperion 1999 Term Trust, Inc., 98 F.3d 2 (2d Cir. 1996) 23

Picard Chemical Inc. Profit Sharing Plan v. Perrigo, 940 F. Supp. 1101 (W.D. Mich. 1996)..... 11

Romani v. Shearson Lehman Hutton, 929 F.2d 875 (1st Cir. 1991) 23

Rubenstein v. Collins, 20 F.3d 160 (5th Cir. 1994)..... 20, 21, 22

TABLE OF AUTHORITIES – Continued

Page

Saltzberg v. TM Sterling/Austin Associates, Ltd., 45 F.3d 399 (11th Cir. 1995) 20

Schneider v. Traweek, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,507 (C.D. Cal. 1990) 12

Schoenfeld v. Giant Stores Corp., 62 F.R.D. 348 (S.D.N.Y. 1974) 12

Sears v. Likens, 912 F.2d 889 (7th Cir. 1990) 11

Semegen v. Weidner, 780 F.2d 727 (9th Cir. 1985) 13

Shapiro v. Miami Oil Producers, Inc., 84 F.R.D. 234 (D. Mass. 1979) 15

Shapiro v. UJB Fin. Corp., 964 F.2d 272 (3d Cir. 1992), *cert. denied*, 506 U.S. 934 (1992) 10, 14, 15

Shaw v. Digital Equipment Corp., 82 F.3d 1194 (1st Cir. 1996) 10, 15, 20

Sheppard v. TCW/DW Term Trust 2000, 938 F. Supp. 171 (S.D.N.Y. 1996) 10

Sinay v. Lamson & Sessions Co., 948 F.2d 1037 (6th Cir. 1991) 20

Stevens v. Equidyne Extractive Industries 1980, 694 F. Supp. 1057 (S.D.N.Y. 1988) 23

Sunkyong Int'l, Inc. v. Anderson Land & Livestock Co., 828 F.2d 1245 (8th Cir. 1987) 14

Tuchman v. DSC Communications Corp., 14 F.3d 1061 (5th Cir. 1994) 16

U.S. v. Morris, 80 F.3d 1151 (7th Cir. 1996), *cert. denied*, ___ U.S. ___, 117 S. Ct. 181 (1996) 21, 22

Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991) 19

TABLE OF AUTHORITIES – Continued

Page

STATUTES

Securities Act of 1933

Section 11, 15 U.S.C. § 77k ..... *passim*

Section 12(2), 15 U.S.C. § 77l 10

Securities Exchange Act of 1934

Section § 10(b), 15 U.S.C. § 78j(b)..... *passim*

RULES

Federal Rules of Civil Procedure

Rule 9(b) ..... *passim*

Rule 12(b)(6) 6

Rules of the Supreme Court of the United States

Rule 10(a) 11

Rule 10b-5, 17 C.F.R. § 240.10b-5..... 4

INTRODUCTION

This is yet another securities class action against a high-tech start-up company based on price fluctuations, not on conduct prohibited by the securities laws. The initial complaint was filed just *two* days after the company's stock price fell. Despite a comprehensive prospectus addressing material risks, the complaint alleged an elaborate scheme to defraud investors perpetrated by virtually everyone involved in bringing the company public. In reality, though, it simply sought a form of insurance against the normal risks of investing in high-tech stocks. The potential for abuse in cases of this type is well recognized, and their economic toll has prompted Congress to heighten substantially the pleading requirements under the federal securities laws to protect companies entering the capital markets. It is therefore vital that the federal courts carefully scrutinize allegations that the securities laws have been violated to ensure that reasonable pleading requirements have been satisfied.

That is all that occurred in this case. Four federal judges carefully examined the allegations in the operative complaint. All four found that the complaint failed to allege a material misrepresentation or omission in the Prospectus under either Section 11 of the Securities Act of 1933 or Section 10(b) of the Exchange Act of 1934. All four found that the Prospectus amply disclosed the allegedly omitted information, and that the complaint failed to allege fraud under Section 10(b) with the particularity required by Federal Rule of Civil Procedure 9(b). In addition, the Ninth Circuit joined every other court of appeals to address the issue and held that because the Section 11 claim "sounded in fraud," it too was subject to Rule 9(b).

Accordingly, the Ninth Circuit affirmed dismissal of the complaint with prejudice.

There is no basis for this Court's review. Contrary to Petitioners' misleading suggestion, there is no conflict among the circuits or with this Court's decision in *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163 (1993), regarding the application of Rule 9(b) to Section 11 claims sounding in fraud. Five circuits have considered the issue, and all unanimously hold that, although fraud need not be pleaded to state a claim under Section 11, if the basis of the claim *is* fraud, the particularity requirements of Rule 9(b) apply. Nor is there any conflict with *Leatherman*, which simply limited Rule 9(b) to averments of fraud or mistake. Where, as here, averments of fraud permeate a Section 11 claim, Rule 9(b) applies by its plain terms, consistent with *Leatherman*. Thus, Petitioners' first "Question" – "can [Rule 9(b)] be applied to claims under Section 11" – raises no controversy worthy of this Court's time and attention.

Nor does it present an important legal issue. The Ninth Circuit's Rule 9(b) holding was not essential to its decision; the Section 11 claims fail even without Rule 9(b). As both courts observed, the Prospectus "fairly overflow[ed]" with "specific and detailed" warnings on the very points that Petitioners allege defendants failed to disclose. Accordingly, Petitioners simply failed to allege a material misrepresentation in the Prospectus, as Section 11 requires. Because that conclusion turns on the unique allegations in this case, and not solely on the application of Rule 9(b), the Ninth Circuit's decision has no widespread application, and presents no legal issue deserving review by this Court.

Nor is Petitioners' second "Question" – whether plaintiffs can plead Section 11 and Section 10(b) claims in the same complaint, without subjecting their Section 11 claims to the heightened pleading requirements for fraud claims – presented here. Nothing in the Ninth Circuit's opinion precludes plaintiffs from pleading both claims together. Rule 9(b) applied to Petitioners' Section 11 claim, not because they pleaded their Section 11 and Section 10(b) claims in the same complaint, but because the basis alleged for their Section 11 claim was fraud. Accordingly, the court logically found that Rule 9(b), which applies to "*all* averments of fraud," should apply to these claims as well.

Petitioners' final "Question" – do "no assurance" disclaimers in a prospectus "immunize" defendants against false statements under the "bespeaks caution" doctrine as a matter of law – has no place here either. The Ninth Circuit did not hold that such disclaimers are necessarily dispositive of defendants' liability. To the contrary, it held only that the multitude of specific warnings and risk disclosures in *this* prospectus, including (rather than solely because of) these disclaimers, adequately informed investors of the matters that were allegedly undisclosed. Thus, Petitioners' quarrel is not with the Ninth Circuit's *articulation* of the bespeaks caution doctrine, which has been adopted by nearly every Circuit, but only with its *application* of that settled principle to the facts here. That decision, correct or not, does not require this Court's review.

Accordingly, the petition should be denied.

STATEMENT OF THE CASE

This action arises out of the May 1992 initial public offering ("IPO") of 3 million shares of common stock by Stac Electronics, Inc. ("Stac"), a developer of data compression products for computers. On July 20, 1992, Stac announced lower-than-expected third quarter results, and the market price of its stock declined. Just two days after Stac's announcement, Petitioners, disappointed investors, sued Stac, its officers and directors (the "Stac defendants") and lead underwriters Alex. Brown & Sons Incorporated and Montgomery Securities (the "Underwriters"). They alleged that the IPO violated Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k ("Section 11"), and Section 10(b) of the Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10(b)(5) (collectively, "Section 10(b)"). App. 184a, 243a-251a.

Petitioners' Second Amended Complaint (the "Complaint"),[1] the subject of this petition, charged that defendants schemed to defraud investors by disseminating false and misleading information in a prospectus

---

[1] Petitioners' Consolidated Amended Class Action Complaint ("First Amended Complaint"), filed on December 4, 1992, made substantially similar allegations, and was dismissed without prejudice by the district court on September 30, 1993. *See gen'ly Anderson v. Clow*, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,807 (S.D. Cal. 1993), App. 113a-152a. Among other things, Petitioners had explicitly alleged that the Prospectus was "fraudulent" and had based their Section 11 claim on the same facts as their Section 10(b) claim. *Id.* at 97,990, App. 134a-135a.

issued in May 1992 in connection with the IPO (the "Prospectus"). App. 173a. In particular, the Prospectus allegedly failed to disclose that Stac's business was entering a period of protracted decline; that competition from Microsoft was imminent; that Stac purposely stalled licensing negotiations with Microsoft to delay its entrance into the market until after the IPO; that the patents on Stac's products were inadequate; and that Stac had offered its customers special terms and discounts that artificially inflated Stac's reported results for the quarter preceding the IPO. *See, e.g.*, App. 211a-212a, 215a, 216a-217a. The scheme was purportedly intended to artificially buoy the value of Stac's stock for the Stac defendants' personal profit and to ensure the success of the IPO. App. 172a-173a, 199a-200a, 218a-219a. The Underwriters allegedly participated in the scheme to earn over $2.5 million in underwriting fees from the IPO. App. 190a-191a.

The Underwriters and the Stac defendants each moved to dismiss the Complaint for failure to state a claim under Rule 12(b)(6), and for failure to plead fraud with particularity under Rule 9(b). The district court granted defendants' motions. Because this was Petitioners' third attempt to state a claim, and because Petitioners had had fourteen months in which to conduct discovery and correct the deficiencies in the Complaint, the district court dismissed it with prejudice.[2] *Anderson v.*

---

[2] The court held that the Section 11 claims failed because the Prospectus disclosed the allegedly omitted facts in ways that rendered the Prospectus's statements not misleading, or because defendants were not required to disclose the purported

Clow, [1994-95 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,367 at 90,525, 90,528 (S.D. Cal. 1994), App. 103a, 111a.

A unanimous Ninth Circuit affirmed, principally on two independent grounds. First, Petitioners' Section 11 and Section 10(b) claims both failed to state a claim under Rule 12(b)(6) because the Prospectus adequately disclosed the information Petitioners claimed was not disclosed. The court found that the Prospectus "fairly overflow[ed]" with "specific and detailed cautionary language" and risk disclosures. *In re Stac Electronics Sec. Litig.*, 89 F.3d 1399, 1409 (9th Cir. 1996), App. 23a. In particular, the Prospectus described in detail the phenomenon and risk of "channel fill," spelled out Stac's liberal return policy, and warned investors of the risk of product returns. *Id.* at 1407-08, App. 17a-19a. Accordingly, to the extent any of the alleged misstatements were forward-looking, such as those concerning the adequacy of Stac's reserves and the risk of product returns, the Complaint failed under the Circuit's "bespeaks caution" doctrine since "investors were specifically and adequately cautioned about the relevant risks." *Id.* at 1409, App. 22a.

---

omissions. *Anderson v. Clow*, [1994-95 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 90,521, App. 88a-89a. The Section 10(b) claims failed for the same reason, and because the Complaint failed to allege fraud with particularity. *Id.* at 90,524-90,525, App. 97a-101a. The District Court did *not* apply the particularity requirements of Rule 9(b) to Petitioners' Section 11 claims. *See id.* at 90,516-90,521, App. 70a-87a; *see also In re Stac Electronics Sec. Litig.*, 89 F.3d 1399, 1403 (9th Cir. 1996), App. 8a. Nor did it rely on the "bespeaks caution" doctrine.

Moreover, to the extent the allegedly concealed information was historical in nature (to which the "bespeaks caution" doctrine did not apply), it too was adequately disclosed in the Prospectus. *Id.*, App. 23a.

The court also held that, whether or not the disclosures in the Prospectus were adequate, Petitioners' Section 11 and Section 10(b) claims failed to comply with the particularity requirements of Rule 9(b). *In re Stac Electronics Sec. Litig.*, 89 F.3d at 1409, App. 22a-23a. Specifically, Petitioners failed to state what was false and misleading about the statements in the Prospectus and why they were false. *Id.* The court reasoned that Rule 9(b) was applicable to Petitioners' Section 11 claims because the "gravamen of the [Complaint was] plainly fraud and no effort [was] made to show any other basis for the claims levied at the Prospectus." *Id.* at 1405 n.2, App. 11a n.2. Accordingly, the claim was "grounded in fraud," *id.* at 1404-05, App. 11a, and properly subject to the heightened pleading standards and protections afforded by Rule 9(b):

> Rule 9(b) serves to give defendants adequate notice to allow them to defend against the charge and to deter the filing of complaints "as a pretext for the discovery of unknown wrongs," to protect professionals from the harm that comes from being subject to fraud charges, and to "prohibit [ ] plaintiff[s] from unilaterally imposing upon the court, the parties and society enormous social and economic costs absent some factual basis." *Semegen v. Weidner*, 780 F.2d 727, 731 (9th Cir. 1985). Because the same policy considerations apply to Section 11 claims sounding in fraud, we hold that persons making such

> claims must state with particularity the circumstances constituting the alleged fraud.

In re Stac Electronics Sec. Litig., 89 F.3d at 1405, App. 12a.

The court reaffirmed its decision by unanimously denying Petitioners' petition for rehearing and suggestion for rehearing *en banc*. *See id.* at 1401, App. 2a; *see also* App. 154a-155a.

REASONS FOR DENYING THE WRIT

I. SUMMARY OF ARGUMENT

This Court should refuse to grant review of this decision for two reasons:

First, nothing in the Ninth Circuit's holding conflicts with a decision of another court of appeals or of this Court.

Second, the decision raises no important federal question requiring this Court's review. Petitioners' Section 11 and Section 10(b) allegations failed, not because the Ninth Circuit adopted the wrong rule, but because the Prospectus disclosed the allegedly omitted facts in ways that rendered the Prospectus's statements not misleading, or because defendants were not required to disclose the purported omissions in the first instance. Even if, *arguendo*, the Ninth Circuit's application of Rule 9(b) and the "bespeaks caution" doctrine was wrong, that finding has no application beyond the parties to this case.

II. THE NINTH CIRCUIT'S DECISION TO APPLY RULE 9(b) TO SECTION 11 CLAIMS SOUNDING IN FRAUD DOES NOT WARRANT REVIEW BY THIS COURT

The Ninth Circuit's Rule 9(b) holding was not essential to its decision; the Section 11 claims fail even without Rule 9(b). Both the district court and the court of appeals held that Petitioners failed to allege a material misrepresentation in the Prospectus because the Prospectus "fairly overflow[ed]" with "specific and detailed" warnings on the very points that Petitioners allege were undisclosed. Because that conclusion turns on the unique allegations and disclosures in this case, the Ninth Circuit's decision has no widespread application, and presents no legal issue deserving review by this Court.

To the extent the Ninth Circuit held that Petitioner's Section 11 claims also failed under the particularity requirements of Rule 9(b), that decision does not warrant review by this Court because it is entirely consistent with the decisions of other courts of appeals, and raises no important federal question.

A. There Is No Conflict On This Issue Among The Courts Of Appeals Or With This Court's Decision In *Leatherman*

Petitioners mischaracterize the law on whether Rule 9(b) applies to Section 11 claims sounding in fraud. Contrary to Petitioners' claim, Petition ("Pet.") at 10, there is no conflict among the courts of appeals on this issue. Nor is there a conflict between any court of appeals' decision

and this Court's decision in *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163 (1993).

Four other circuits have directly addressed the issue – the First, Third, Fifth and Seventh – and all unanimously agree with the Ninth Circuit that, while a plaintiff need not plead fraud to state a claim under Section 11, once the plaintiff does so, Rule 9(b) applies.[3] *See Shaw v. Digital Equipment Corp.*, 82 F.3d 1194, 1223 (1st Cir. 1996) ("[D]espite the minimal pleading requirements of Sections 11 and 12(2), a complaint asserting violations of those statutes may yet 'sound[ ] in fraud,' " and Rule 9(b) would apply); *Melder v. Morris*, 27 F.3d 1097, 1100 n.6 (5th Cir. 1994) ("When 1933 Securities Act claims are grounded in fraud rather than negligence as they clearly are here, Rule 9(b) applies."); *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 287-89 (3d Cir. 1992), *cert. denied*, 506 U.S. 934 (1992) (where complaint is devoid of allegations that defendants acted negligently in violating Section 11, and instead "brims with references to defendants' intentional

---

[3] Although the Second Circuit has not directly addressed the issue, it has affirmed without explanation a lower court decision holding that Rule 9(b) applies to claims under Section 12(2) of the Securities Act of 1933 that sound in fraud. *Moran v. Kidder Peabody & Co.*, 609 F. Supp. 661, 666 (S.D.N.Y. 1985), *aff'd*, 788 F.2d 3 (2d Cir. 1986) (Rule 9(b) applies to claims under Section 12(2) "to the extent that such claims 'sound[] in fraud, a conclusion which may be assumed if the alleged misstatements are those generally referred to earlier in the complaint'."); *see also Sheppard v. TCW/DW Term Trust 2000*, 938 F. Supp. 171, 179 n.6 (S.D.N.Y. 1996) (quoting *Moran*, and holding that Rule 9(b) applies to claims under Sections 11, 12(2) and 15 of the 1933 Securities Act to the extent they sound in fraud).

and reckless misrepresentation," the claim is grounded in fraud and Rule 9(b) applies); *cf. Sears v. Likens*, 912 F.2d 889, 892-93 (7th Cir. 1990) (applying Rule 9(b) to § 12(2) claim).[4]

Nevertheless, Petitioners, by misdescribing several district court opinions, repeatedly and misleadingly claim there is "disarray" among the "lower courts." *See* Pet. at 10 & n.4; *see also* Pet. at 15 n.9. But disagreements among some district courts are not a basis for certiorari. *See* Supreme Court Rule 10(a) (certiorari may be based on "conflict with the decision of another United States court of appeals").

More fundamentally, Petitioners' district court cases are inapposite. None involved Section 11 claims "sounding in fraud," and several suggest that had such claims been at issue, Rule 9(b) would have applied. *See, e.g., In re AnnTaylor Stores Sec. Litig.*, 807 F. Supp 990, 1003 (S.D.N.Y. 1992) ("Since plaintiffs disavow any claim of fraud or mismanagement in [their Section 11 claim], it need not comply with Rule 9(b)."); *In re Lilco Sec. Litig.*, 625 F.

---

[4] Numerous district courts have reached the same conclusion. *See, e.g., Picard Chemical Inc. Profit Sharing Plan v. Perrigo*, 940 F. Supp. 1101, 1115 (W.D. Mich. 1996); *Degulis v. LXR Biotechnology, Inc.*, 928 F. Supp. 1301, 1310 (S.D.N.Y. 1996); *Neubauer v. Eva-Health USA, Inc.*, 158 F.R.D. 281, 283 n.1 (S.D.N.Y. 1994); *Lucia v. Prospect Street High Income Portfolio, Inc.*, 769 F. Supp. 410, 416 (D. Mass. 1991), *aff'd*, 36 F.3d 170 (1st Cir. 1994); *In re Chambers Development Sec. Litig.*, 848 F. Supp. 602, 624 (W.D. Pa. 1994); *Haft v. Eastland Financial Corp.*, 755 F. Supp. 1123, 1132-33 (D.R.I. 1991); *Hershey v. MNC Financial, Inc.*, 774 F. Supp. 367, 375-76 (D. Md. 1991); *Competitive Associates, Inc. v. Fire Fly Enterprise, Inc.*, 59 F.R.D. 336, 337 (S.D.N.Y. 1972).

Supp. 1500, 1502 (E.D.N.Y. 1986) ("the Court does not find that these [Section 11] claims . . . incorporate allegations of fraud"); *Schneider v. Traweek*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,507 at 97,662 (C.D. Cal. 1990) (Rule 9(b) inapplicable because Section 11 claims at issue sounded in negligence, not fraud); *Husted v. Amrep Corp.*, 429 F. Supp. 298, 310 (S.D.N.Y. 1977) (noting that even if Rule 9(b) did apply to violation of Section 1709(a) of the Interstate Land Sales Act modeled after Section 11, its requirements were met by the allegations of complaint); *Schoenfeld v. Giant Stores Corp.*, 62 F.R.D. 348, 350-51 (S.D.N.Y. 1974) (distinguishing its decision not to apply 9(b) from cases in which the "nub of the allegations . . . sounded in fraud"). Accordingly, there is no conflict in decisions worthy of this Court's attention.

Nor does the Ninth Circuit's decision conflict with this Court's decision in *Leatherman*. *See* Pet. at 10, 14-15. *Leatherman* simply limits Rule 9(b) to the two instances specifically mentioned in the Federal Rules: namely, averments of fraud and mistake. *Leatherman*, 507 U.S. at 168. Here, the Ninth Circuit found that Petitioners alleged a Section 11 claim in name only, and that, in fact, Petitioners' averments of fraud so permeated the Complaint that their Section 11 claim inevitably "sounded in fraud" as well. Applying Rule 9(b) to a Section 11 claim based on averments of fraud is entirely consistent with *Leatherman*.

B. The Decision Was Reasonable And Does Not Raise An Important Federal Question

The Ninth Circuit's application of Rule 9(b) to the Section 11 claim in this case makes sense. Rule 9(b)

requires particularity in "*all* averments of fraud or mistake," Fed. R. Civ. P. 9(b) (emphasis added), not just those brought under Section 10(b). Its heightened pleading standards serve an important screening function against bogus fraud claims, whatever form they may take: they ensure that defendants will have fair notice of plaintiff's claim; prevent complaints from being used "as a pretext for the discovery of unknown wrongs"; and safeguard reputations – especially those of outside professionals whose reputations in their fields of expertise are most sensitive to slander – from the harm that comes from charges of fraud.[5] *See Semegen v. Weidner*, 780 F.2d 727, 731 (9th Cir. 1985); *accord Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 52 (2d Cir. 1995).

Petitioners argue that Rule 9(b) should not apply because their Section 11 claim specifically excluded allegations of fraud. Pet. at 18. The Ninth Circuit, however, found Petitioners' attempts to segregate their claims "nominal" and "unconvincing" because the gravamen of the complaint was obviously fraud: the Section 11 claim lacked any independent basis and instead adopted

---

[5] The *in terrorem* effect of nuisance actions in complex security fraud cases like this one is well-recognized. "[T]o the extent [discovery] permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal evidence, it is a social cost rather than a benefit." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975); *accord In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 263 (2d Cir. 1993), *cert. denied*, ___ U.S. ___, 114 S. Ct. 1397 (1994); *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir.), *cert. denied*, 498 U.S. 941 (1990).

wholesale the allegations of securities fraud elsewhere in the Complaint.[6] *In re Stac Electronics Sec. Litig.*, 89 F.3d at 1405 n.2, App. 11a n.2; *cf. Shapiro v. UJB Fin. Corp.*, 964 F.2d at 288 (applying Rule 9(b) to Section 11 claim where complaint was devoid of allegations that defendants

---

[6] Despite Petitioners' "nominal" disclaimer, the specific factual allegations incorporated by reference into Petitioners' Section 11 count clearly averred that defendants acted fraudulently by misrepresenting and omitting to represent certain material information knowingly, recklessly and/or intentionally. *See* App. 169a and 119a (Stac defendants undertook the IPO to allow them to cash out before adverse facts became public); 172a, 178a-179a, 201a, 203a (Stac's insiders undertook to artificially inflate Stac's reported results and conceal softening demand for its products by offering customers special terms); 188a, 194a (defendants "knew or recklessly disregarded" the misrepresentations and omissions from the Prospectus and that facts were being concealed from the public); 200a (Stac's insiders commenced licensing negotiations with Microsoft to delay Microsoft's announcement of a competing product); 230a (Underwriters agreed to issue very positive reports on Stac in exchange for being selected as the underwriters for the IPO); 241a (Stac's insiders manipulated revenues and earnings).

Moreover, Petitioners' Section 11 claim in the First Amended Complaint was explicitly grounded in fraud. *Anderson v. Clow*, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 97,990, App. 134a (emphasis in original) ("[T]he [First Amended] Complaint alleges not just that there were untrue statements or misleading omissions. It alleges that the Prospectus was *fraudulent*."). These former allegations are admissible against Petitioners as admissions. *See American Title Ins. Co. v. Lacelaw Corp.*, 861 F.2d 224, 226 (9th Cir. 1988); *Sunkyong Int'l, Inc. v. Anderson Land & Livestock Co.*, 828 F.2d 1245, 1249 n.3 (8th Cir. 1987).

acted negligently, but was replete, as here, with references to defendants' intentional and reckless misrepresentations). Despite its label, therefore, it was essentially a fraud claim, and entitled defendants to the protections of Rule 9(b). *See id.* at 1404-05 & n.2, App. 11a-12a & n.2; *accord Melder v. Morris*, 27 F.3d at 1100 n.6; *Shapiro v. UJB Fin. Corp.*, 964 F.2d at 288. To have held otherwise would have elevated form over substance. As one court explained:

> The mere fact that plaintiffs need not prove scienter to recover under §§ 11 and 12(2) does not mean that §§ 11 and 12(2) claims can never "sound in fraud." On the contrary, a plaintiff may allege [under those sections] a scheme which, if proven, would constitute fraud. That is precisely what plaintiffs have done here. The gist of their claims is that [defendant] embarked upon a scheme fraudulently to overstate its financial health. . . . While they have invoked §§ 11 and 12(2) as legal bases for these claims, the gravamen of their case is fraud. . . . [¶] [Rule 9(b)'s] application should depend on the substance of a plaintiff's allegations, not upon the guise in which he portrays them.

Hershey v. MNC Financial, Inc., 774 F. Supp. 367, 375-76 (D. Md. 1991); *accord Shaw v. Digital Equipment Corp.*, 82 F.3d at 1223 ("It is the allegation of fraud, not the 'title' of the claim that brings the policy concerns [underlying Rule 9(b)] . . . to the forefront."); *cf. Shapiro v. Miami Oil Producers, Inc.*, 84 F.R.D. 234, 236 (D. Mass. 1979) (Rule 9(b) extends to averments of fraud or mistake, "whatever may be the theory of legal duty – statutory, tort, contractual, or fiduciary").

Petitioners cannot avoid this conclusion by contending that they are not required to "show" any basis for their Section 11 claim because it rests on "strict liability." *See* Pet. at 18 n.14. Rather, as the court of appeals held, they must "*adequately* . . . allege a material misrepresentation or omission." *In re Stac Electronics Sec. Litig.*, 89 F.3d at 1403, App. 8a; *In re VeriFone Sec. Litig.*, 11 F.3d 865, 868-69 (9th Cir. 1993). Here, the court found they did not. Whether or not that decision was correct, the sufficiency of Petitioners' attempts to state a claim under Section 11 is a narrow issue, turning on the nature of the allegations peculiar to this case.[7] It is not an important issue of law warranting certiorari.

---

[7] The need for particularity was especially important here because the Underwriters' alleged involvement in the scheme to defraud investors was inherently implausible. *See Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1068-69 (5th Cir. 1994) (plaintiffs face a "more stringent [pleading] standard" when fraud claims are based on an irrational theory); *DiLeo v. Ernst & Young*, 901 F.2d at 629 (same). The institutional investors Petitioners claim the Underwriters so willingly deceived are the lifeblood of their business. When a company is brought public, the brokerage firms acting as the company's underwriters purchase the entire stock offering at a discount and sell it, principally to institutional investors, who are the firms' regular customers, and who trust them to place their money into sound investments. A brokerage firm risks losing these clients and damaging its reputation in the market by recommending an investment in a company that later experiences an unexpected reversal in earnings. Accordingly, an analyst or brokerage firm would not knowingly market a bad stock to its customers, or perpetuate the deception by distributing misleading research reports after the offering, merely to earn the limited fees the firm realizes from the offering itself. *See In re VeriFone Sec. Litig.*,

Petitioners' contention that the opinion below will lead to a multiplicity of suits is also meritless. Pet. at 16-21. Nothing in the Ninth Circuit's ruling or the decision of any other court of appeals prohibits plaintiffs from joining Section 11 and Section 10(b) claims in one complaint. Indeed, courts have had no difficulty in construing such claims separately when they are properly pleaded. *See, e.g., Degulis v. LXR Biotechnology, Inc.*, 928 F. Supp. at 1310 (noting that the Section 11 and 12(2) claims against one defendant surely sound in fraud, while those against another group of defendants "seem more clearly to sound in negligence" and are not subject to Rule 9(b)); *In re Chambers Development Sec. Litig.*, 848 F. Supp. at 624 (specific paragraphs incorporated into Section 11 claim support the inference that it is predicated on negligence, not fraud). Here, Petitioners simply failed to segregate their Section 11 and 10(b) claims. Whether or not the court construed their allegations correctly, its conclusion raises no important question for this Court. The interpretation of a particular complaint is too fact-intensive an inquiry to have widespread application.

---

784 F. Supp. 1471, 1481 (N.D. Cal. 1992), *aff'd*, 11 F.3d 865 (9th Cir. 1993) ("the professional analyst has more interest in making the most accurate prediction possible, because the analyst's reputation and livelihood depend solely on the analyst's ability to be correct"); *see also Melder v. Morris*, 27 F.3d at 1104 n.10 ("to think that the underwriters would put their valuable professional reputation at risk to ostensibly 'profit' from two relatively minor securities offerings presents an inference of irrationality we refuse to indulge").

III. THE NINTH CIRCUIT'S APPLICATION OF THE "BESPEAKS CAUTION" DOCTRINE DOES NOT WARRANT REVIEW BY THIS COURT

Petitioners also try to manufacture an issue for review concerning the "bespeaks caution" doctrine. They repeatedly claim that the court of appeals improperly "immunized" the defendants and foreclosed liability solely because the Prospectus contained "boilerplate" warnings that "there can be no assurance" that certain events or conditions (such as the adequacy of Stac's reserves) would turn out as anticipated. *See* Pet. at 25; *see also* Pet. at 21. That is not what the Ninth Circuit held.

Although the numerous disclosures and warnings in the Prospectus, including the "no assurance" disclaimers, were found to be adequate in this instance, nothing in the Ninth Circuit's opinion holds or even implies that dismissal is *always* warranted because of the presence of "no assurance" language. To the contrary, the opinion emphasizes that the statements must be analyzed "in context," *In re Stac Electronics Sec. Litig.*, 89 F.3d at 1408, (App. 21a), and that dismissal is *precluded* unless the "challenged documents include *enough* cautionary language or risk disclosure that reasonable minds could not disagree that the challenged statements were not misleading." *Id.*, 89 F.3d at 1408, App. 20a (emphasis in original). As the court explained:

> [T]he 'bespeaks caution' doctrine has developed to address situations in which optimistic projections are coupled with cautionary language . . . affecting the reasonableness of

> reliance on and the materiality of those projections. To put it another way, the 'bespeaks caution' doctrine reflects the unremarkable proposition that statements must be analyzed in context.

Id., App. 21a, *quoting In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1414 (9th Cir. 1994), *cert. denied*, ___ U.S. ___, 116 S. Ct. 185 (1995).[8]

The court then applied the doctrine to the *forward-looking* statements in *this* case, including information in the Prospectus about the adequacy of Stac's reserves:

> Analyzing the quoted statements in context leads to the inexorable conclusion that investors were specifically and adequately cautioned about the relevant risks. Insofar as Stac's alleged misstatements can be viewed as "optimistic projections," they are more than adequately covered by the bespeaks caution doctrine.

Id., App. 22a.

---

[8] The principle is consistent with this Court's statement in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991):

> [w]hile a misleading statement will not always lose its deceptive edge simply by joinder with others that are true, the true statements may discredit the other one so obviously that the risk of real deception drops to nil. . . . [Therefore,] publishing accurate facts . . . can render a misleading proposition too unimportant to ground liability.

Id. at 1097. *See In re Worlds of Wonder Sec. Litig.*, 35 F.3d at 1415; *see also Harden v. Raffensperger, Hughes & Co., Inc.*, 65 F.3d 1392, 1405 (7th Cir. 1995).

As to the alleged misstatements and omissions that were necessarily historical in nature, the court, without applying the doctrine, concluded that the Prospectus as a whole "adequately disclosed" the information Petitioners alleged defendants had concealed.[9] *In re Stac Electronics Sec. Litig.*, 89 F.3d at 1409, App. 23a. Accordingly, the Prospectus was not misleading as a matter of law.

There is nothing remarkable, or reviewworthy, in the court's holding or analysis, and they are indisputably correct. Virtually every circuit has embraced the "bespeaks caution" doctrine and articulated substantially the same rule. *See, e.g., Shaw v. Digital Equipment Corp.*, 82 F.3d at 1213-14; *Harden v. Raffensperger, Hughes & Co.*, 65 F.3d at 1404; *Rubenstein v. Collins*, 20 F.3d 160, 166-68 (5th Cir. 1994); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371-73 (3d Cir. 1993), *cert. denied*, 510 U.S. 1178 (1994); *Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 949 F.2d 243, 245-46 (8th Cir. 1991); *Sinay v. Lamson & Sessions Co.*, 948 F.2d 1037, 1040 (6th Cir. 1991); *I. Meyer Pincus & Assocs. v. Oppenheimer & Co.*, 936 F.2d 759, 763 (2d Cir. 1991); *see also Gasner v. Board of Supervisors*, No. 96-1010, 1996 WL 741803, *5-*8 (4th Cir., Dec. 31, 1996); *Saltzberg v. TM Sterling/Austin Associates, Ltd.*, 45 F.3d 399, 400 (11th Cir. 1995).

None of these courts held that a particular disclaimer or disclosure is always sufficient. To the contrary, it is

---

[9] Thus, Petitioners' statement that the court erroneously applied the "bespeaks caution" doctrine to historical statements in the Prospectus, *see* Pet. at 23, misreads the opinion below.

well-settled (even among the authorities on which Petitioners rely) that whether cautionary language cures otherwise misleading statements can be determined only on a case-by-case basis. *See, e.g., U.S. v. Morris*, 80 F.3d 1151, 1167 (7th Cir. 1996) ("[T]he effect of cautionary language on an otherwise misleading statement must be assessed on a case-by-case basis"), *cert. denied*, ___ U.S. ___, 117 S. Ct. 181 (1996); *Harden v. Raffensperger, Hughes & Co., Inc.*, 65 F.3d at 1404 ("Courts apply this narrow fact-intensive defense on a case-by-case basis[.]"); *Rubinstein v. Collins*, 20 F.3d at 167-68 (same); *Krim v. BancTexas Group, Inc.*, 989 F.2d 1435, 1448-49 (5th Cir. 1993) (whether cautionary language and disclosures of adverse facts affects materiality is determined by analyzing particular facts of the case); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d at 371-73 (application of the doctrine depends on the specific text of communications at issue and the nature of the cautionary language).

Accordingly, there is no conflict among the courts of appeals as to whether "bespeaks caution" applies to such disclaimers, as Petitioners contend. *See* Pet. at 26. Nor does any of Petitioners' cases support their claim that "no assurance" language is always insufficient as a matter of law. *See* Pet. at 23. *See, e.g., U.S. v. Morris*, 80 F.3d at 1167; *Harden v. Raffensperger, Hughes & Co., Inc.*, 65 F.3d at 1404; *Rubinstein v. Collins*, 20 F.3d at 167-68 & n.27 (all holding that the adequacy of warnings and disclosures must be determined on a case-by-case basis).

Moreover, Petitioners' cases are inapposite because they involve the adequacy of "no assurance" disclaimers relating to statements of historical *fact* that were knowingly false or had no reasonable basis when made, not to

forward-looking statements. In *U.S. v. Morris*, for example, the defendant bank received an in-depth review of its loan portfolio (the "SA") recommending an additional $9.3 million in loan loss reserves *before* it issued an offering circular stating it believed reserves were "adequate." *Id.* at 1155. In light of the bank's actual knowledge at the time of the offering, a disclaimer in the circular that there could be "no assurance" that additional loan loss reserves would not be necessary in the future was plainly inadequate and misleading.[10] *Id.* at 1168. Similarly, in *Harden v. Raffensperger, Hughes & Co.*, 65 F.3d at 1406, the "no assurance" disclaimer concerning the outcome of an application for federal insurance was insufficient because the company allegedly knew, *before* it issued the registration statement, that there was no possibility that the application would be approved. In *Rubinstein v. Collins*, 20 F.3d 160 at 168-169, the "no assurance" disclaimer concerning the size and value of a recently-discovered natural gas

---

[10] The *Morris* court made this clear in its opinion, but Petitioners deleted that portion of the court's explanation in the block quote on page 24 of their petition. The court actually said:

> The language relied upon by defendants here does nothing more than to apprise potential investors that actual losses in the portfolio cannot now be predicted with absolute certainty. . . . The uncertain nature of predicting future loan losses does not neutralize the misleading character of this statement *when the government proved to the jury's satisfaction that management's "present analysis" (the SA) actually recommended the doubling of existing reserves.* The qualifying statements thus do not exhaust the capacity of the adequacy statement to mislead.

U.S. v. Morris, 80 F.3d at 1168 (emphasis added).

reserve was inadequate because the company allegedly knew at the time of the prospectus of adverse test results that suggested the reserves were much smaller than originally thought.[11]

In sum, this case raises no important question warranting this Court's review. Petitioners' Complaint failed, not because the Ninth Circuit adopted the wrong rule, but because their allegations were insufficient in the context of the myriad disclosures made in this *particular* Prospectus. Petitioners' real complaint is not with the Ninth Circuit's *articulation* of the doctrine, which was correct, but with its *application* to this case. The application of settled law to facts, however, does not provide a basis for certiorari, even if the court below applied the law incorrectly. The court's decision here, based on the correct rule of law, and the unique facts before it, will have no impact beyond the immediate parties to this

---

[11] Petitioners' corresponding contention (again, to suggest that a conflict exists) that other courts routinely "accept" no assurance disclaimers, Pet. at 21-22 & n.16, is also false. None of the authorities petitioners cite in support of that proposition relied solely on a "no assurance" disclaimer to determine liability. Instead, each court based its holding on a variety of disclosures and warnings, including "no assurance" disclaimers, that it construed as a whole in the context of the offering materials at issue. *See, e.g., Olkey v. Hyperion 1999 Term Trust, Inc.*, 98 F.3d 2, 6 (2d Cir. 1996); *Glassman v. Computervision Corp.*, 90 F.3d 617, 635-36 & n.27 (1st Cir. 1996); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 879 (1st Cir. 1991); *Luce v. Edelstein*, 802 F.2d 49, 56 (2d Cir. 1986); *In re Computervision Sec. Litig.*, 869 F. Supp. 56, 60-61 & n.3 (D. Mass. 1994); *Stevens v. Equidyne Extractive Industries 1980*, 694 F. Supp. 1057, 1063-64 (S.D.N.Y. 1988).

litigation. Thus, this case raises no question requiring this Court's review.

CONCLUSION

There is no reason for this Court to review this case, which presents neither a conflict in decisions nor any important federal question. The petition should be denied.

Respectfully submitted,

JOHN R. REESE*
CHARLENE S. SHIMADA
HENRY A. CIRILLO
McCUTCHEN, DOYLE, BROWN
& ENERSEN, LLP
Three Embarcadero Center
San Francisco, California 94111
Telephone: (415) 393-2000

Attorneys for Respondent
Alex. Brown & Sons Incorporated
and Montgomery Securities

**Counsel of Record*

January 31, 1997.